



DEPARTMENT OF STATE A/CDC/MR

REVIEWED BY: [Signature] DATE: 7/28/81
PORTIONS DENIED AS INDICATED

EXCISE 7/28

DEPARTMENT OF STATE

Washington, D.C. 20520

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TO : E - Mr. Trezise

FROM : E/ORF - Julius L. Katz

SUBJECT : Oil Problems in Libya and the Middle East -
ACTION MEMORANDUM

Attached Annex A spells out current and potential problems caused by production cutbacks in Libya and the closure of Tapline. The resulting tanker shortage has caused shortages in the US of residual fuel oil and asphalt, threatened to curtail air pollution regulations, and could severely hurt the profitability of small inland refiners. If the situation continues to deteriorate it could lead to rapid changes in existing patterns of US oil ownership in the Eastern Hemisphere and severe political strains between us and our European allies (and to a lesser extent with Japan).

Annex B spells out in some detail existing problems between oil companies and the Libyan government. Annex C reviews the Tapline problem. Annex D reviews the tanker situation.

ACTION RECOMMENDED

1. That you call in representatives of US oil companies in Libya,-- at least Esso and Occidental -- express our concern over the seriousness of the situation there, ask for their assessment of the situation, and urge they seek every means available to deal imaginatively with the problem of seeking to accommodate themselves with the foreseeable evolution of events in Libya, consonant with their own long-term best interests.

2. That you speak to Aramco representatives, express our concern with the wide-spread effects the temporary closure of Tapline is having, the more serious effects should Tapline remain closed for the rest of this year or longer, ask for

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their assessment of the situation, and urge they make every effort to work something out with Syria and other transit countries consonant with Aramco's best interests.

If you approve in principle to this approach, we will send you separate memoranda on the talking points.

Attachments

Cleances: E/FSE - Mr. Akins *fu*
AF/N - Mr. Bray *fu*
NEA/ARP - Mr. Murphy *fu*
NEA/ARN - Mr. Scotter *fu*

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ANNEX A

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Effects of Current Oil Problems in the Arab World

Summary

The closure of Tapline and cutbacks in oil production in Libya have caused a tanker shortage and increased crude oil and petroleum product prices in Europe. The chances for reopening Tapline soon are only fair. The probability of increasing production in Libya in the foreseeable future is not promising; the real problem in Libya is to avoid further cutbacks.

The effect in the US has been a shortage of residual fuel oil and asphalt, and a reduction in oil imports. There is the immediate threat that air pollution regulations will have to be suspended, and the possibility if the tanker crisis continues that some small US refiners may be forced out of business because they will have no markets for their import tickets.

Our NATO allies are thinking of making direct deals with governments of oil producing countries if oil deliveries are further curtailed. If Arab oil is partially or wholly denied US companies because of arms shipments to Israel or other reasons, the USG will be in an awkward position between the interests of our companies and the requirements of our friends in Europe. A crisis could be reached if Mediterranean oil production were reduced another 400,000 to 900,000 barrels per day. End Summary

I. The Tanker Shortage

The world supply and price of crude oil and petroleum products has been severely affected by the very rapid recent increases in tanker rates to very high levels caused by the shutdown of Tapline, production cutbacks ordered in Libya, and expectations of further shortages. Spot tanker rates have more than doubled, radically shifting trade patterns. It is now more economical for Europeans to import the marginal barrel from Venezuela rather than the Persian Gulf, and it is more economical to consume the whole barrel of Middle East

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and African crude in Europe than to export residual oil and other products to the United States. The cost advantage of Middle East or African oil delivered to the East Coast over crude produced in the US used to be about \$1.40 per barrel. This advantage has now almost disappeared and may be negative in some cases. US oil imports from Venezuela and the Eastern Hemisphere have correspondingly dropped.

The high tanker rates initially affect only the small amount of world trade on the spot or short term tanker market (about 20 percent of tankers in operation) but rates for one year charters have also risen. The cost of operating long term charters (12 years) or tankers owned by oil companies (which together makes up about 70 percent of the world tanker fleets) are affected only indirectly. However, any oil company seeking new tanker capacity to fulfill its contracts, such as Occidental which needs to replace production in Libya with crude located further from its markets, will have to pay the going high prices.

Major oil companies with their own fleets and established markets to supply will also experience cost increases because of the need to conserve scarce tanker capacity by using it on the shortest possible routes, even if this means using high cost Venezuelan oil in some cases instead of cheaper Persian Gulf oil.

II. Duration of Current Tanker Shortage

Construction of tankers at current rates is barely enough to keep up with growing demand in Europe and Japan. World shipyards are full and booked up for the next two or three years. If the Tapline and Libyan situation remain as they are now the current high tanker rates can be expected to last for at least another two or three years until world shipyard capacity can be increased.

1. Chances of Reopening Tapline

The Syrians claim their only interest in Tapline is to increase transit payments. They want a \$50 million payment to allow the line to be reopened and to start negotiations for a new agreement. Tapline has offered a \$5 million "advance" payment plus forgiveness of a \$7 million debt. Both sides at present seem far from agreement.

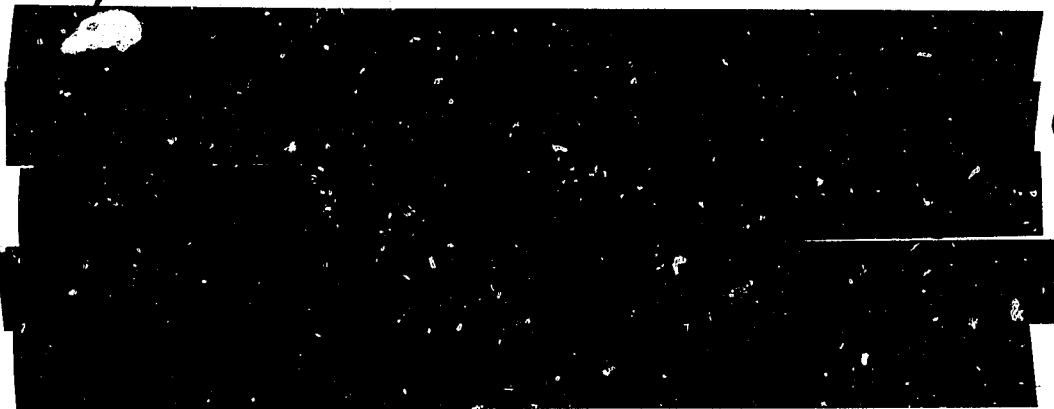
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We understand some Aramco members themselves may not be anxious to reopen Tapline. Companies with large tanker fleets may be relatively better off during a period of high tanker rates than companies who are tanker short. Companies without enough tankers of their own would of course be anxious to reopen the line.

The chances of reopening Tapline soon must therefore be judged fair at best.

2. Chances of Increasing Production in Libya

Since Libya has cut back production in the name of conservation, it might be expected that such cut backs will be more or less permanent. In their zest for conservation the Libyans may be partially motivated by the desire for more detailed oil field data. It has been a long-standing Libyan goal to get such data from the companies, as is done in the United States, so that authorities can accurately judge whether in fact a field is being produced too fast or not. It is possible that if the companies present the Libyans with enough data in defense of the higher production rates, some production increase might eventually be allowed.

The immediate threat in Libya is the possibility of further reductions which could take place in the name of conservation, higher posted prices for Libyan oil, Arab-Israeli politics, or a combination of these factors.

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The Libyan government is understood to be thinking of imposing higher posted prices on the oil companies by decree. Such a move would not necessarily affect the rate of production in Libya.

III. Affect on US

1. Residual fuel oil and asphalt

Almost all residual fuel oil used in the US for generating electricity and other industrial purposes is imported from the Caribbean and Europe. With decreased imports, supplies of resid are so short that a shortage has also developed of asphalt, which can be made instead of resid in the refinery process. Asphalt supplies are now being rationed to customers by suppliers.

2. Pollution regulations

Existing anti-pollution regulations in many US cities, especially in the Northeast, require the use of low sulphur resid. Much of this has been imported as a "left over" from refineries in Western Europe using low sulphur Libyan oil. The continued tanker shortage and reduced US imports of resid from Western Europe will necessitate the use of resid with higher sulphur content from the Caribbean. This could mean the suspensions of some existing anti-pollution regulations as well as delay of more stringent regulations.

3. Small inland refiners

Many small inland refiners in the US depend on the value of their import tickets for a substantial part of their operating revenue. In some cases net profits are less than the value of the import tickets. The value of these tickets is now nearly zero, although the effect on most refiners has not yet been felt because most inland refiners exchanged their year's supplies of tickets with importers last January when the tickets were worth \$1.25 to \$1.45 per barrel. Should high tanker rates remain into next year, however, the inland refiners will be badly hurt.

IV. Affect on our allies

Western European countries are concerned over the security of their oil supplies. [REDACTED]

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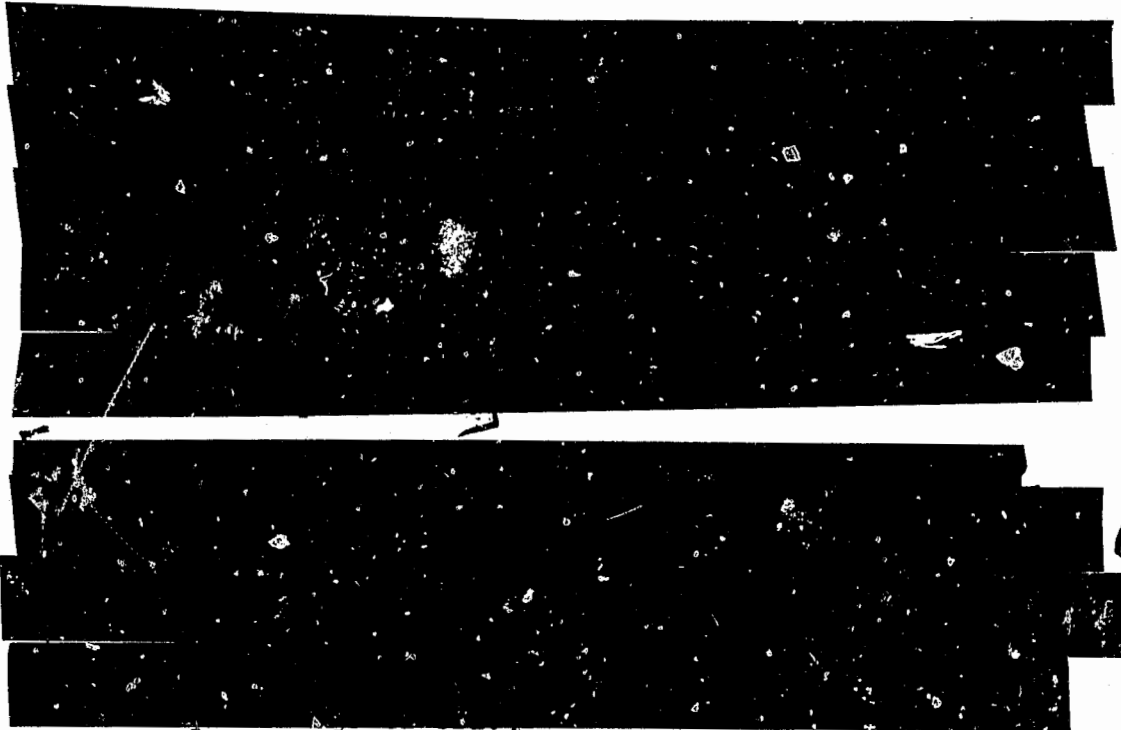
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V. Crisis Point

Under present very tight tanker supply conditions, industry representatives have told us that Mediterranean oil production (Libya, Algeria and the IPC pipeline) can only be reduced another 400,000 to 900,000 barrels per day before Europe would actually be forced by the shortage of available tankers to begin to draw down stocks.

Reductions in the availability of Mediterranean oil so far have been justified on the basis of demands for increased transit payments in the case of Tapline, and oil field conservation in the case of cut backs in Libya. Further small cut backs may be made in Libya for conservation reasons, but any major cut backs by Iraq, Algeria, or Libya of up to one million barrels per day would probably be made for political reasons or to apply pressure to increase posted prices in Libya.



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ANNEX B

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Outstanding Issues Regarding Petroleum in Libya

I. Posted Prices

Negotiations between oil companies and the Libyan government over posted prices have made little progress. The problem is urgent. There are strong indications that the oil companies involved are faced with a choice of negotiating an increase of [REDACTED] within the next month or of having a higher price increase forced on them by decree. Some major oil companies may prefer to be forced into a higher price to protect their interests elsewhere, but the interests of US companies without major interests outside Libya would not appear to be served by this approach. US interests in general would appear best served by negotiating problems rather than ignoring them, [REDACTED]

1. Negotiating History

[REDACTED]

In 1969 under the ancien régime of King Idris, the Libyan government asked the oil companies to increase the posted price by 10 cents because Libyan oil with higher gravity (and therefore higher value) and lower sulphur content had the same posted price as lower gravity, higher sulphur oil at Sidon and Banias. The oil companies refused.

Following the revolution in September 1969 the Libyans demanded a 44 cent increase in the posted price. From September to March of this year oil companies stoutly maintained there was no economic justification for any increase at all.

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Embassy Tripoli reported that Esso described the attitude of Libyan negotiators during this period as friendly and conciliatory, trying to elicit some favorable response from Esso. At a meeting March 14, the Libyan negotiators led by Petroleum Minister Mabruuk reduced their demands to a posted price increase of 13 cents retroactive to 1965, increasing by one cent per year to 23 cents in 1975.

On April 11 Esso finally responded with the offer of a five cent increase with no retroactivity. Apparently in frustration over the slow pace of negotiations and lack of results, the Libyan Revolutionary Command Council (RCC) on April 14 established a new committee to negotiate the posted price headed by ex-Prime Minister Maghrabi who was responsible only to the RCC, not the Petroleum Ministry.

On May 6 Maghrabi told Esso its demands were now a 44 cent "correction" of the posted price, retroactive to 1961, plus a 35 cent premium retroactive to June 1967.

June 19 Esso restated its offer to Petroleum Minister Mabruuk (while Maghrabi was out of the country), describing a package which he said was worth a seven cent increase in the posted price. Mabruuk described the offer as "laughable", being worth less than the April 11 offer by Esso.

One June 28 Maghrabi said the posted price "correction" must still be 44 cents, but the Suez premium could be reduced to 17 cents as of 1967, rising to 35 cents by 1975. On June 30, Maghrabi reduced the "correction" from 44 to 37 cents.

On July 1 Esso offered a package which included a ten cent increase in the posted price and a five cent tax allowance which would reduce the actual increase in taxes paid. Esso has thus effectively increased its offer from zero to about seven cents while the Libyans have reduced their 44 cent demands by about seven cents.

2. Efforts at Conciliation

Petroleum Minister Mabruuk and his Deputy Qaablawi have repeatedly told Esso and the Embassy that a settlement could

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be made if only Esso would make an offer in the neighborhood of a 20 cent increase. [REDACTED] B4

[REDACTED] an offer made then by Mabruuk of 18 cents retroactive to 1967 progressing to 23 cents in 1975 had been sanctioned by the RCC. Following the announcement July 21 of a 79 cent increase in the tax reference price in Algeria, the minimum acceptable posted B1 price increase now in Libya is probably [REDACTED]

[REDACTED] B1

[REDACTED]

[REDACTED] B1

II. Other Issues

1. Conservation

The Libyan government has long been concerned that because Libyan oil is so profitable [REDACTED] B1

[REDACTED] that Occidental and other companies were producing their fields too fast. We have heard such reports about Libya from US geologists as well. All the production cut-backs of some 550,000 b/d decreed by the LARG so far have been in the name of conservation, and Embassy Tripoli believes the LARG is sincere in its intent.

An important issue in the LARG's desire to conserve its limited petroleum resources is the need for oil field data so that the government can determine the maximum efficient rates of production as is done in the United States. Oil

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companies have been reluctant to give such data to the LARG, [REDACTED] (S)

[REDACTED] It's possible that by furnishing the LARG with more detailed oil field data the government could be convinced to allow companies to increase production on some fields, or at least not to force further reductions.

2. Libyanization

[REDACTED] Most concession contracts signed in the late 1950's stipulated that after ten years 75 percent of employees of producing oil companies would be Libyan nationals. [REDACTED] (S)

3. [REDACTED] (S)

4. Other Issues

Libyans have proposed port dues for oil tankers, increased welfare projects for workers such as housing at company expense, and have held up gas exports from Esso's LNG plant pending renegotiation of the tax structure for gas.

III. Oil Company Attitudes on these Issues

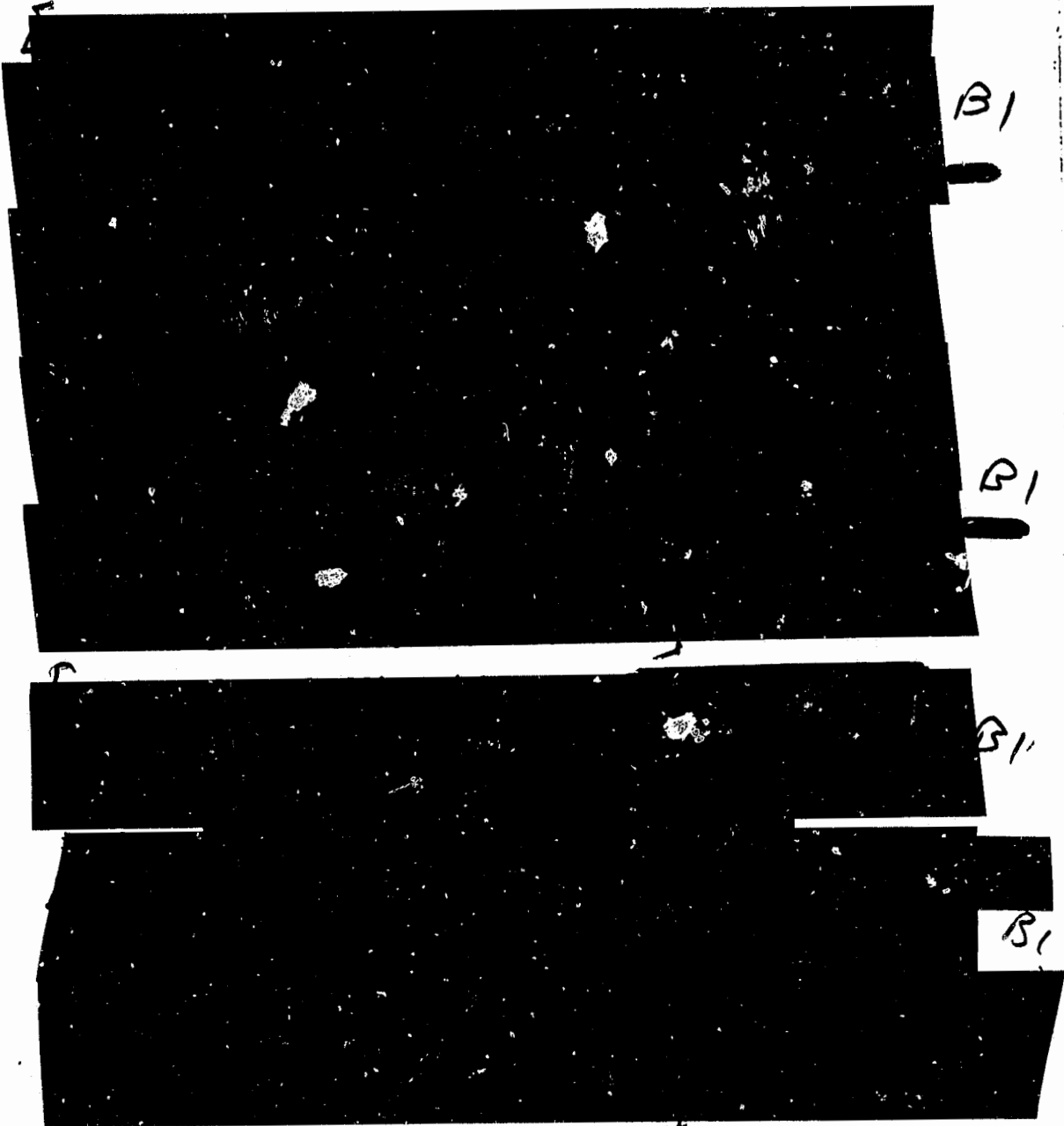
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